Mitch on the Markets

Fireworks, Tariffs and the Trade War with China

By Mitch Zacks
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When most Americans think about the 4th of July, we think of family time, barbeques, hot dogs, red white and blue, fun in the sun, and maybe a few cold beers too. But perhaps the most iconic modern-day American tradition surrounding the 4th of July is, of course, fireworks.

Though it may be difficult to believe, fireworks are actually getting caught up in the ongoing U.S. – China trade dispute, underscoring just how far-reaching the tariffs from both nations have become. The U.S. is currently poised to impose new 25% tariffs on $300 billion worth of Chinese imports, and this latest batch includes goods like fishing reels, electric blankets, and – pertinent to the 4th of July – fireworks.[1]

The 273 categories of goods on the new tariff list include myriad consumer goods, 90% of which are imported from China. As the tariffs loom, U.S. businesses are increasingly voicing concern that they are hard-pressed to find substitutes for imports and supply chain components. In the spirit of the 4th of July, the *Wall St. Journal* recently featured a fireworks company experiencing these exact trade-related hardships. The company, Atlas PyroVision Entertainment based in New Hampshire, can't seem to find domestic substitutes for fireworks imported from China. [1]

Atlas PyroVision used to make fireworks domestically, but rising costs and the rise of globalization made domestic production uneconomical relative to the option of moving supply chains abroad. This shift in business wasn't necessarily a recent phenomenon for Atlas – they stopped making their own fireworks in the U.S. in 1995.

Since then, they've largely been importing from China, much like a majority of U.S.-based fireworks retailers. The U.S. Census Bureau estimates that 86% of fireworks used for shows in the U.S. are imported from China, a figure that's progressively been on the rise. The CEO of Atlas PyroVision, Stephen Pelkey, stated that he does not even have the option of getting his fireworks containers from U.S. companies, because there are no manufacturers operating in the space.

Competitive pricing drove them out years ago.

In response to the tariffs, some U.S.-based fireworks retailers have looked elsewhere to Vietnam, Cambodia, India, and Mexico, but the consensus is that businesses cannot find the same quality and price as China's version of the fireworks. The notion of upstarting U.S. manufacturers to produce fireworks substitutes is far-fetched, as the infrastructure and training needed to get up and running would be far too high.[2]

This fireworks story, in a sense, represents a high-level reality for corporations caught in the web of tariffs and the trade war. It's not to say that tariffs are inherently good or bad, and I'm not weighing in on whether or not they will ultimately be effective. Time will tell. But the reality on the ground for many U.S. companies who use Chinese manufacturers as component suppliers, or who import from China directly, is that the trade war stands to directly affect supply chains and costs. And higher costs for sellers means higher costs for consumers.

Where Does the Trade Issue Go from Here?

As it stands today, the 25% tariffs on $300 billion of Chinese imports is not in effect, and market watchers are very closely eyeing the meeting between President Trump and President Xi Jinping at the G20 summit in Japan. Though the Commerce Department has indicated that this meeting is not expected to generate an actual breakthrough, many are hoping and expecting that in the very least it will bring both sides back to the negotiations table.

The two leaders have gotten along in the past, so the possibility of progress feels possible. However, reports this week indicate that President Xi Jinping plans to present President Trump with a list of terms that the U.S. should meet before China becomes willing to arrive at a deal. Among those 'terms' include the dropping of current punitive tariffs and an agreement to end the U.S. ban on selling U.S. technology to China's telecommunications behemoth, Huawei Technologies. In my view, this is a tall order I'm not sure the U.S. will like.[3]

Bottom Line for Investors

As you celebrate the 4th of July this year, it's important to remember that the United States still has the largest and most diverse economy in the world. Not only do we produce more goods and services every year than any other nation, our economy is also resilient to shocks and has weathered trade wars – and real wars – throughout history. As the U.S. and China dig in for what could be an extended trade dispute, I'd still argue that the base case for the U.S. is to see growth over 2% in 2019. And that's worth celebrating.

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] The Wall Street Journal, June 16, 2019. https://www.wsj.com/articles/as-china-tariffs-loom-some-u-s-companies-say-buying-american-isnt-an-option-11560677402

[2] The Wall Street Journal, June 16, 2019. https://www.wsj.com/articles/as-china-tariffs-loom-some-u-s-companies-say-buying-american-isnt-an-option-11560677402

[3] The Wall Street Journal, June 27, 2019. https://www.wsj.com/articles/when-it-comes-to-tariffs-many-u-s-companies-are-on-chinas-side-11561627806

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